

General Information Letter: Tax treatment of qualified Subchapter S subsidiaries.

July 9, 1998

Dear:

This is in response to your letter dated June 30, 1998, to Director Ken Zehnder, which was forwarded to me for response. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

The 1996 Small Business Job Protection Act (the "96 Act") amended the Internal Revenue Code ("Code") to permit qualifying corporations and their wholly owned subsidiaries to elect S corporation status. In such cases, the parent can elect to treat all of its subsidiaries as if the parent and the subsidiaries were collectively one corporation for federal income tax purposes. The subsidiaries are called "QSSS" subsidiaries under the relevant federal S corporation provisions, and are treated as divisions of the parent company.

My questions are:

1. Does your Department or Commission intend to follow this specialized tax treatment for your state's income or franchise tax purposes?
2. If not, is it your opinion that legislation would be required in order to permit state tax treatment that would conform to the federal treatment?
3. Would you please provide me with copies of or citations for any notices, regulations or other rulings that your state has issued on this topic?

Ruling

For the reasons discussed below, the State of Illinois does follow the federal tax treatment of a qualifying Subchapter S subsidiary ("QSSS") and its parent.

Section 1501(a)(28) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 et seq.) provides:

The term "Subchapter S corporation" means a corporation for which there is in effect an election under Section 1362 of the Internal Revenue Code . . .

Section 1362 of the Internal Revenue Code permits a "small business corporation" to elect taxation as a Subchapter S corporation. The term "small business corporation" is defined in Section 1361(b) of the Internal Revenue Code, which provides, in part:

(3) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.-- (A) IN GENERAL.--
-For purposes of this title--

- (i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and
- (ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

(B) QUALIFIED SUBCHAPTER S SUBSIDIARY.--For purposes of this paragraph, the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation (as defined in paragraph (2)), if--

- (i) 100 percent of the stock of such corporation is held by the S corporation, and
- (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

Section 102 of the IITA provides:

Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 or any successor law or laws relating to federal income taxes and other provisions of the statutes of the United States relating to federal income taxes as such Code, laws and statutes are in effect for the taxable year.

Section 1501(a)(4) of the IITA provides:

The term "corporation" includes associations, joint-stock companies, insurance companies and cooperatives. Any entity, including a limited liability company formed under the Illinois Limited Liability company Act, shall be treated as a corporation if it is so classified for federal income tax purposes.

Pursuant to Section 1361(b)(3) of the Internal Revenue Code, a QSSS is not a separate corporation, but rather is defined to be a part of its parent Subchapter S corporation for all purposes of the Internal Revenue Code. Because this definition is expressly adopted by the IITA, a QSSS is not a separate corporation for Illinois income tax purposes. Instead, the QSSS is by definition part of its parent Subchapter S corporation, and its assets, liabilities, and items of income, deduction, and credit must be included with the assets, liabilities, and items of income, deduction, and credit of its parent Subchapter S corporation in determining the Illinois income tax liabilities of the parent and its shareholders.

A Subchapter S corporation and any QSSS it owns must therefore file an Illinois income tax return as a single corporation and include all items of income, deduction and credit of the parent and the QSSS in the return. No separate election is required for Illinois purposes.

The franchise tax imposed under 805 ILCS, Article 15, is administered by the Secretary of State, rather than the Department of Revenue. For questions regarding the franchise tax, please contact:

Office of the Illinois Secretary of State
Department of Business Services
Room 328
Springfield, Illinois 62756

A copy of Letter Ruling IT 98-0018-GIL, which is the most comprehensive statement on QSSS issues published by the Department to date, is attached for your reference.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Paul S. Caselton
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